Internal Revenue Service

memorandum

CC:TL:TS/P
TKANE/lmr

date: APR 12 1991

to: Assistant District Counsel, Newark CC:MA:NEW
Attn: William F. Malley

from: Chief, Tax Shelter/Partnerships Branch CC:TL:TS/P

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subject: [redacted]
Request For Technical Advice-TEFRA Issue

This is in response to your request for technical advice regarding the captioned matter dated January 24, 1991.

ISSUE

What is the effect of the failure to bring a TEFRA proceeding for a TEFRA subchapter S item in [redacted] within the three year period of I.R.C. § 6229(a), with regard to the computation of an individual's NOL carryback to the years [redacted], [redacted] and [redacted], under the facts set forth below. Put another way, is it permissible to compute, by reference to I.R.C. § 6214(b), the correct carryback loss to an open carryback year ([redacted] even if the individuals's loss is partially composed of a TEFRA subchapter S corporation loss in the loss year ([redacted] and the I.R.C. § 6229(a) statute of limitations has expired without any TEFRA proceeding having been begun for that loss year?

CONCLUSION

It is permissible to compute the correct carryback loss to an open carryback year, i.e., [redacted] even if the loss generating the carryback is partially composed of TEFRA subchaper S items and arose in a year, i.e., [redacted], for which the statute of limitations under I.R.C. § 6229(a) has expired without any TEFRA proceeding having been begun for [redacted]. However, in determining whether or not there is an income tax deficiency for the taxpayers' [redacted] taxable year, the potential disallowance and/or adjustment of subchapter S items for the taxable year [redacted] cannot be taken into consideration.

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FACTS

The facts, as set forth in your request, are set forth below:

1. This case involves the years [redacted] through [redacted].

2. Taxpayers' [redacted] return was timely filed on [redacted], and is open under timely executed Forms 872 and 872-A (unrestricted).

3. Taxpayers' [redacted] return was timely filed [redacted], and is open under timely executed Forms 872 and 872-A (unrestricted).

4. Taxpayers' [redacted] return was timely filed [redacted], and is open under a timely executed Forms 872 and 872-A (unrestricted).

5. Taxpayers' [redacted] and [redacted] returns were timely filed and are open under timely executed Forms 872-A(unrestricted).

6. On or about [redacted], [redacted] ("[redacted]") was incorporated. [redacted] had [redacted] shareholders (all individuals) and filed its initial return for the taxable year ending [redacted], as a subchapter S corporation (Form 1120S).

7. On its [redacted] return, [redacted] showed a loss of $[redacted]. Taxpayer [redacted]'s share of such loss ([redacted]) in the amount of $[redacted] flowed through to his [redacted] Form 1040.

8. Taxpayers' Form 1040 for [redacted] showed a net loss (including the above subchapter S corporation share of loss) of $[redacted].

9. No portion of the above loss for [redacted] was carried back by the taxpayers to [redacted], [redacted], or [redacted] or forward to [redacted] (a loss year). It is not known if any portion was carried to [redacted] or subsequent years.

10. No NBAP or FSAA or other subchapter S corporation proceeding has been initiated with regard to [redacted]'s [redacted] year and no extensions under I.R.C. § 6229(b)(1) or (2) have been solicited or secured.

11. In a proposed notice of deficiency for [redacted], various adjustments totalling $[redacted] have been proposed. One of the proposed adjustments involved the conversion of [redacted] from an S corporation to a regular C corporation for failure to file the required election on Form 2553 required by I.R.C. § 1362.

12. Your office is making changes to the other proposed adjustments that would result in there being no deficiency for [redacted] even if the [redacted] adjustment would be sustained. That is, the adjustments would not overcome the reported loss of $[redacted].

DISCUSSION

The answer to your question involves an issue of statutory construction concerning the relationship between I.R.C. § 6214(b) and the TEFRA provisions found at I.R.C. §§ 6221 et. seq. As such, we must analyze the history and application of these statutory provisions.

Subchapter S Items

In terms of the relationship between I.R.C. § 6214(b) and the TEFRA provisions, it must first be determined what is or is not a subchapter S item.

Clearly, whether a proper election has been made to be treated as a subchapter S corporation under I.R.C. § 1362 is a subchapter S item. See Temp. Treas. Reg. §§ 301.6233-1T(b) and 301.6245-1T(a)(3). Additionally, and as a direct result of any decision regarding the subchapter S status of a corporation, each shareholder's share of items of income, gain, loss, deduction, or credit are considered to be subchapter S items. See Temp. Reg. § 301.6245-1T(a)(1)(i). However, after a decision has been made regarding (1) the valid status of a corporation as a subchapter S corporation and (2) the shareholders' taxable portion of the items of income, gain, loss, etc., any utilizable loss that properly flows through to the shareholder becomes commingled, in a sense, with any other tax attributes of the shareholder that would go to make up the shareholder's net operating loss for the year. Thus, although there may be certain components of a subchapter S shareholder's net operating loss for any particular year that consist of subchapter S items, the carryback and/or carryover of that net operating loss at the shareholder level are not, in and of themselves, TEFRA items.

I.R.C. § 6214(b)

The predecessor to I.R.C. § 6214(b), section 274(g) of the Revenue Act of 1926, stated:

> Sec. 274(g) The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in doing so shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

When compared with the present version of I.R.C. § 6214(b), it can be seen that the operative words of the two statutory provisions have remained virtually unchanged:

> (b) JURISDICTION OVER OTHER YEARS AND QUARTERS.- The Tax Court in redeterminining a deficiency of income tax for any taxable year . . . shall consider such facts with relation to the taxes for other years . . . as may be necessary correctly to redetermine the amount of such deficiency, but in doing so shall have no jurisdiction to determine whether or not the tax for any other year has been overpaid or underpaid.

In Cornelius Cotton Mills, 4 B.T.A. 255, 256 (1926), the Board of Tax Appeals addressed the meaning and application of prior law section 274(g):

> The Board is to have jurisdiction of appeals from the determination of a tax liability for those years for which the Commissioner has determined a deficiency. In determining the correct amount of the deficiency, we may consider such facts with relation to taxes for other taxable years as may be necessary correctly to redetermine the amount of the deficiency involved; for example, in determining the invested capital for the year for which the deficiency against a corporation has been determined, we may determine what was the tax liability during a preceding year.

In construing the scope of I.R.C. § 6214(b), the Tax Court, in Lone Manor Farms, Inc. v. Commissioner, 61 T.C. 436, 440-41 (1974), aff'd without pub. op., 510 F.2d 970 (3rd Cir. 1975), stated:

> Section 6214(b) says that we have no power to determine an overpayment or underpayment of tax for a year not in issue which would form the basis of a refund suit or an assessment of a deficiency. (citations omitted) It does not prevent us from computing, as distinguished from "determining", the correct tax liability for a year not in issue when such a computation is necessary to a determination of the correct tax liability for a year that has been placed in issue. (citation omitted) Nor is the rationale of the decided cases limited to situations where the recomputation of the tax liability for the barred year involves the propriety of omissions or deductions from gross income for such year; it extends to a recomputation of the tax liability itself, even though no adjustments are made to taxable income. (Emphasis added)

In addressing the mechanics of applying I.R.C. § 6214(b), the Tax Court recently stated, in Hill v. Commissioner, 95 T.C. No. 31 (October 18, 1990):

> Indeed, in that open year, as petitioners emphasize, a taxpayer may be forced to contest respondent's adjustments for a year long past in a dispute regarding the proper amount of a deficiency determined for the open year. The period of limitations set forth in section 6501(a), however, does not save a taxpayer from shouldering that burden.

The TEFRA Provisions

As a starting point, I.R.C. § 6221 provides the general rule underlying the TEFRA provisions (P.L.97-248):

> SEC. 6221. TAX TREATMENT DETERMINED AT PARTNERSHIP LEVEL
>
> Except as otherwise provided in this subchapter, the tax treatment of any partnership item shall be determined at the partnership level. (Emphasis added)

The legislative history accompanying the enactment of the TEFRA partnership provisions states:

> Under the conference agreement, the tax treatment of items of partnership income, loss, deductions, and credits will be determined at the partnership level in a unified partnership proceeding rather than in separate proceedings with the partners.
>
> Except as otherwise provided [under the TEFRA provisions], the tax treatment of any partnership items is to be determined at the partnership level. (Emphasis added)

H.R. Conf. Rep. No. 760, 97th Cong., 2nd Sess. 600 (1982), 1982-2 C.B. 600, 662.

Following closely on the heels of the enactment of the TEFRA partnership provisions, the Subchapter S Revision Act of 1982 (P.L. 97-354) made rules similar to the TEFRA partnership rules applicable to subchapter S corporations as well. More specifically, I.R.C. § 6241 states the general rule applicable to subchapter S corporations:

> SEC. 6241. TAX TREATMENT DETERMINED AT CORPORATE LEVEL
>
> Except as otherwise provided in regulations prescribed by the Secretary, tax treatment of any subchapter S item shall be determined at the corporate level. (Emphasis added)

The legislative history accompanying the enactment of the TEFRA subchapter S corporation provisions states:

> Under the bill, the tax treatment of items of subchapter S income, loss, deductions, and credits will be determined at the corporate level in a unified proceedings with shareholders. (Emphasis added)

H.R. Rep. No. 826, 97th Cong., 2d Sess. 24 (1982), 1982-2 C.B. 730, 741.

I.R.C. § 6229, the TEFRA partnership provision that sets forth the rules and limitations for assessing any tax relating to partnership items, is applicable to subchapter S corporations and subchapter S items by virture of the cross reference provisions of I.R.C. § 6244.

It should be self evident from the emphasized portion of the quoted exerpts, supra, that the TEFRA provisions, whatever else they may or may not be, provide a mechanism for determining an income tax liability. As the legislative history to the TEFRA partnership proceedings, supra, states, the TEFRA provisions are intended to consolidate the determination proceedings and replace the multiple determination process that was in place prior to the enactment of the TEFRA provisions. There is virtually nothing in the statutes or the legislative history accompanying the pieces of 1982 TEFRA legislation that suggest or imply, directly or indirectly, that Congress was intending to or did in fact limit the broad scope of I.R.C. § 6214(b), which gives the Tax Court the jurisdiction to "compute" the tax liability for a year not properly before it in order to determine the correct tax liability for a year that is properly before it. See Lone Manor Farms, Inc., supra. Without specifically addressing the issue, it would be extremely difficult to conclude that Congress sub silentio intended to limit the scope of I.R.C. § 6214(b) to non-TEFRA issues. In fact, the consistent use of the word "determined," a term of art in the tax law, is strong support for the proposition that the historical distinction between "determine" and "compute" for purposes of I.R.C. § 6214(b) remain intact under the TEFRA provisions as well.

In light of our conclusion regarding the scope of I.R.C. § 6214(b), supra, under your facts, the effect of the potential TEFRA adjustments for [redacted]'s [redacted] taxable year can be taken into account in determining the taxpayer's correct income tax liability for the earlier, open years. However, in determining whether or not there is an income tax deficiency for the taxpayers' [redacted] taxable year, the potential disallowance and/or adjustment of subchapter S items for the taxable year [redacted] cannot be taken into consideration.

If you have any questions regarding these issues, do not hesitate to call Thomas J. Kane at FTS 343-0032.

CURTIS G. WILSON
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